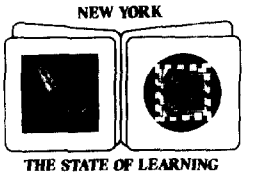

THE STATE EDUCATION DEPARTMENT

EXECUTIVE DEPUTY COMMISSIONER OF EDUCATION
THE NEW YORK STATE EDUCATION DEPARTMENT
ALBANY, NEW YORK 12234

August 1, 1996

Office of the Secretary
Federal Communications Commission
Room 222
1919 M Street
Washington, D.C. 20554

Office of the Secretary:

Please find enclosed comments by the New York State Education Department in Response to Specific Questions In Universal Service, Notice of Proposed Rulemaking, CC DOCKET No. 96-45.

Sincerely,

Thomas E. Sheldon

Attachment

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SUMMARY OF COMMENTS

The New York State Education Department appreciates this opportunity to participate in the Joint Board hearings on the implementation of the Telecommunications Act of 1996. We also appreciate the goal of Congress and the FCC to reduce the costs of telecommunications services to schools and libraries. The Board of Regents has made the integration of telecommunications and information technologies into the learning environment one of its priorities. We therefore endorse any incentive that will enable technology to enrich the learning experience and make educational resources available to all learners.

While we support the intent of the legislation we do, however, have several concerns with some of the implementation mechanisms that are the focus of this round of comments. Our primary concern is with the universal service mechanism and whether it is the best way to achieve the desired results. First, because universal service has been limited to narrow band technologies and because the future of technology use for education and research will require broadband technologies, it may be that the use of a universal service mechanism may not be the most effective mechanism for either reducing broadband rates or ensuring widespread access to broadband services. Second, although the mechanism for collecting and distributing Universal Service Funds has not been defined, it is most certainly true that any universal service-based mechanism will be unnecessarily burdensome, particularly if it is in the form of a block grant. Most important of all, we worry that the universal service approach could ultimately "chill" true competition in the telecommunications markets thereby causing rates for education to be artificially inflated at the same we are trying to effect reductions. We therefore suggest that any final recommendations on universal service be consistent with the proceedings on "access" charges.

We also suggest that the Joint Board should ensure that "affordable" rates are determined through competition and actual costs, thereby circumventing any potential hidden price floors. In terms of promoting competition, we argue that the universal service support mechanisms could be used as an incentive for companies to provide access to advanced broadband services if access to advanced services was added as a requirement for "core" services. We also advocate that the discount pricing methodology for schools and libraries should use rates established through a competitively-bid contract as the base service price. Finally, we argue that the universal service support mechanism take into account an institution's ability to pay. States should be given the flexibility to distribute universal support subsidies based on measures such as wealth and geographic location.

COMMENTS

INTRODUCTION

The following general remarks reflect major policy concerns that may not be adequately addressed in the individual questions. They are intended to enhance and provide context to our responses to the individual questions.

- As a general guiding principle in all deliberations of the Joint Board, we subscribe to the New York State Public Service Commission's recommendation that states be given maximum flexibility in the design of interstate funding mechanisms and the distribution of all federal funds.

- We continue to be concerned whether the Universal Service Fund mechanism is the most efficient or effective way to achieve the discount rate goals for schools, libraries, and rural health providers. A review of the volume and the complexity of the first round responses to the March 8 NPRM underscores this concern. The concept of universal service has already proved itself to be complicated and flawed so it seems that adding additional burdens will create more unnecessary complexity

- Likewise, there is no evidence that even if an efficient Universal Service Fund program can be designed, that it would generate meaningful discount rates. We think that the FCC could probably fulfill Congress' intent of lower rates by ensuring that fair "access charges" prevail in the local exchange market. More so than anything else, this would create a genuinely competitive marketplace that would produce meaningfully reduced rates for schools and libraries. Educational institutions could then aggregate their "bulk purchasing" power to bargain with all providers for the lowest possible rates and the best services. We therefore recommend that if the FCC has authority to do so, it delay any ruling on this NPRM until after its proceeding on access charges. We also think that the FCC should give a priority to: encouraging competition for all telecommunications services; creating incentives for full digitalization of the public switched network; and protecting the public interest in media company mergers before the Department of Justice.

- In addition to the practical concerns about the Universal Service Fund, we also continue to question whether universal service should be a "given" with respect to ensuring affordable access to telecommunications services for schools and libraries. That is, in the evolving deregulated marketplace, it appears that the conventional telephony model is not the best way to provision telecommunications networks for broadband services.

- We recognize that public institutions have historically benefited from regulation. We also acknowledge that many of our colleagues in the education and research communities

believe that this historical precedent will continue with the deliberations of the Joint Board. Yet, our experience with telecommunications issues requires us to question whether burdensome regulations in universal service will hinder the development of competition. This is ironic because the trend in federal and state regulatory policy over the past several years has been to create unfettered competition in the hopes that the public interest will be better served -- i.e., lower rates, more services, and better service. We are in no position to know with any degree of certainty whether this goal will ultimately be achieved, but we nevertheless remain concerned that the Universal Fund approach could inadvertently impede the testing of the hypothesis that true competition really does benefit the public.

- These deliberations on universal service need to clarify the ambiguity in language regarding which services are to be considered as eligible for funding. Our priorities in education and research continue to be on broadband services. Yet, it is not clear whether advanced services are eligible for discounts. We continue to assert that subsidies should be established for both "special" and " advanced" services for both access *and* use.

- As a general statement, the "cost" bases to be used for calculating the size of the universal service fund are not reflective of true cost. Cost-based pricing in the telecommunications industry has typically not reflected true costs. As a result, companies have received more money from universal service than is needed. We think that companies should not be able to use these "profits" from universal service as part of their business planning.

- Companies should be required to provide access to "advanced" telecommunications services as a prerequisite for receiving reimbursements from the Universal Service Fund. Companies that only provide telephony services should not be eligible for universal service funds.

- Finally, we continue to be concerned that neither the Congress nor the FCC has addressed the possible unintended implications for education policy of a Universal Service Fund program. That is, the support provisions envisioned by these deliberations will unavoidably be viewed by other categories of ratepayers as a "tax" for education. This could have serious consequences for other educational programs in the current political climate where education is being portrayed as an excessive expense for taxpayers.

RESPONSES TO SPECIFIC QUESTIONS

1.) Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

It is not "appropriate" to assume that current rates are affordable for services that may be included within the definition of universal service. Some services are not even accessible by

many institutions because they are not currently provided. As documented, significant disparities in pricing exist from region to region for the same company and between companies in the same regions. "Affordability" is a relative term and many companies do not base pricing on actual cost, but on economic models that reflect an estimate of what the consumer is willing to pay for services. The notion that business rates subsidize residential rates, for example, should not apply to educational institutions. This kind of pricing methodology was only partially viable under rate cap regulation and probably not viable at all under competitive rules. The notion of "affordable rates" should be developed within the context of a competitive telecommunications environment. In theory, pricing under the rules of true competition is likely to diminish cost levels instead of having them inflated by overly protective regulatory structures.

Equally important to this issue is the telephony-oriented practice of establishing "access" rates. This practice of establishing access rates introduces price floors, below which companies cannot operate on a level playing field with their competition. This type of pricing regime, and the continued practice of requiring local loop pricing for access to broadband services, must be fully investigated before access fees are accepted as a pricing component for universal service funding. As mentioned in the Introduction, it is for this reason that universal service policies should probably come after the establishment of rules and regulations for access charges -- not before.

2.) To what extent should non-rate factors, such as subscribership level, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?

Determination of affordability and reasonable comparability of rates should take other factors into consideration including cost differentials between categories of rate payers. Factors to be considered for residential ratepayers may not be appropriate for business/institutional ratepayers, and a model for determining affordability for residential consumers may not be appropriate for other sectors. Also, the models developed for affordability of telephony services may not pertain to affordability of other services such as broadband services.

3.) When making the "affordability" determination required by Section 254 (I) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

The establishment of a national benchmark rate for core services, as required in Section 254 (I) should follow a principle of using the most efficient and least intrusive mechanism for determining affordability. However, states should not be precluded from establishing alternatives that best fit the conditions of their individual states or that result in lower cost solutions to the national benchmark model

4.) What are the effects on competition if a carrier is denied universal service support because it is technically infeasible for that carrier to provide one or more of the core services?

All carriers considered as eligible for universal service support should be capable of providing core services at a minimum. Carriers should not be given the opportunity to "cherry pick" certain services (e.g., broadband services), with an additional advantage of universal service subsidies.

5.) A number of commenters proposed various services to be included on the list of supported services, including access to directory assistance, emergency assistance, and advanced services, although the delivery of these services may require a local loop, do loop costs accurately represent the actual cost of providing core services? To the extent that loop costs do not fully represent the costs associated with including a service in the definition of core services, identify and quantify other costs to be considered.

Most likely, the cost of the local loop does not adequately represent the cost of providing core services such as access to emergency services or access to advanced telecommunications services. In the instance of advanced telecommunications services, for example, switching facilities and links and ports need to be "conditioned" in order to accept signals from standard telephone lines. In the event that the Joint Board recommends access to advanced telecommunications services as a core services requirement, then companies should be allowed to recover these costs. However, because this access is not a requirement at this time, the costs of providing these services to institutional consumers such as schools and hospitals should not be recoverable under universal service provisions because these services are more likely to be subject to competitive pricing.

6.) Should the services or functionalities eligible for discounts be specifically limited and identified, or should the discount apply to all available services?

The current law relating to the establishment of the universal service fund is relatively prescriptive and the FCC and the Joint Board should resist the opportunity to add the trappings of an entitlement program to its provisions. Both the constituencies it is supposed to serve (in this case schools and libraries) and the providers it is intended to compensate may be inclined to extend the provisions of the program beyond its original intent. While we understand that resource-poor schools and libraries may want to do this, it is ultimately not in their economic self-interest to rely on universal service types of financing. Moreover, if the size of the fund becomes too large, it will take on an economic life of its own. Schools may feel entitled to the benefits of the program regardless of its impact on other classes of ratepayers, and telecommunications providers may feel compelled to "compete" for the dollars contained in the fund. In any case, it is our interpretation of the law that discount rates should only apply to a set of basic, core or "special" services that would be applied across the country.

7.) Does Section 254(h) contemplate that inside wiring or other internal connections to classrooms may be eligible for universal service support of telecommunications services provided to schools and libraries? If so, what is the estimated cost of the inside wiring and other internal connections?

Section 254 (h) does not appear to make provision for the use of funds to support the costs of inside wiring or other internal connections to classrooms or other facilities. Nor does it preclude a company from including the bundling of inside wiring and equipment into the cost of providing telecommunications services. Section 254 (h) should be interpreted to preclude universal service support for inside wiring or other internal connections to facilities. There are unlimited combinations of internal configurations for telecommunications infrastructure that would need to be accommodated and any attempt to establish minimum capacities or "standard" configurations would limit the flexibility of organizations and provide inappropriate advantages to certain providers. Universal service funding provisions should not be used to create alternative funding opportunities for internal infrastructure development for public institutions at the expense of other categories of ratepayers.

8.) To what extent should the provisions of Sections 706 and 708 be considered by the Joint Board and be relied upon to provide advanced services to schools, libraries and health care providers?

Universal service provisions should not have an adverse impact on the capacity of the Commission or the Joint Board to promote competition in the telecommunications marketplace or to stimulate appropriate public/private partnerships or private investment in the technology infrastructure of schools and libraries. The FCC's efforts to develop incentives for competition (Section 706) and to effectively implement the National Educational Technology Funding Corporation (Section 708) should represent at least a commensurate level of priority with the establishment of regulatory structure for the implementation of the universal service fund.

9.) How can universal service support for schools, libraries, and health care providers be structured to promote competition?

Mechanisms used to provide universal service support for schools, libraries and health care providers should be subordinate to those developed for promoting competition in the establishment of advanced telecommunications services. Further, universal service support should be allocated after "best case" discount pricing arrangements have been negotiated by consumers through the use of aggregated market pricing strategies promoted by state regulatory agencies. Aggressive implementation of Section 706 of the Telecommunications Act would ensure that universal service provisions are developed within an appropriate context where competition has already produced price reduction. Further, universal service mechanisms are most appropriately applied to telephony-based services.

Perhaps the most effective long term strategy would be for the universal service support mechanism to be used as an incentive for telecommunications providers to offer advanced telecommunications network services if a requirement to provide access to advanced services was added to the list of "core services" that companies must provide. Providing incentives for investing in broadband telecommunications infrastructure through recovery of a part of the costs

from the universal service fund may increase the number of companies that could compete, with the result that consumers may have more choice in the selection of broadband providers.

10.) Should the resale prohibition in Section 254 (h) (3) be construed to prohibit only the resale of services to the public for profit, and should it be construed so as to permit end user cost based fees for services?

The resale prohibition, as stated in Section 254 (h), should be enacted literally as stated. The notion of "profit" in the context of revenue generation is nebulous, cumbersome, time-consuming and difficult to quantify. More importantly, it is a concept that more than likely conflicts with the core mission of the institution. Further, the relaxation of the resale provision for schools and libraries might establish an incentive for these institutions to build telecommunications capacities that are inconsistent with technological growth, thereby possibly impeding community network development. Resale strategies developed by schools and libraries will also be viewed by providers as anti-competitive, with the result that institutions may not have an opportunity to participate in discount pricing programs offered by the companies. The aggregation of "traffic" through a single agency also has no effect on aggregate pricing methodologies that could be used to reduce the cost of service. Institutions sharing the cost of a service will not have any impact on the actual market rates for these services; in fact, providers may decide to maintain higher pricing (or increase pricing) to compensate for shortfalls in projected volume of use. In short, relaxation of resale provisions will be inconsistent with other regulatory efforts designed to promote competition

11.) If the answer to the first question in number 10 is "yes," should the discounts be available only for the traffic or network usage attributable to the educational entities that qualify for the Section 254 discounts?

Not applicable.

12.) Should discounts be directed to the states in the form of block grants?

The initial comments and reply comments filed with the FCC presented multiple interpretations of a so-called block grant approach. There does not appear to be a general consensus on what kind of mechanism should be used to aggregate the funds for this purpose at the federal level and then to distribute them to the states. It nevertheless appears that some sort of ratepayer taxation will be employed whereby each company either through the state or directly will contribute its share to a federal Fund. Then, apparently, this fund will be distributed to states on some sort of block grant approach to be determined.

We oppose any sort of block grant approach for the states. Block grants typically create bureaucratic and policy problems that undermine the effectiveness of the ultimate objective of the programs - namely ensuring lower rates to schools and libraries. Our experience with other

education block grant programs suggests that inequities are invariably created and administrative requirements become burdensome.

We endorse the analysis of the National School Boards Association that the Act does not mention the use of a grant process to decide which entities will receive funding, or the issuance of vouchers entitling a school district to a certain dollar value of service. It is our interpretation that Congress intended for *all* schools and libraries to receive the benefits of the universal service mechanism.

13.) Should discounts for schools, libraries, and health care providers take the form of direct billing credits for telecommunications services provided to eligible institutions?

Yes. The discounts for schools and libraries should take the form of direct billing credits from the providers to the eligible institutions.

14.) If the discounts are disbursed as block grants to states or as direct billing credits for schools, libraries, and health care providers, what, if any, measures should be implemented to assure that the funds allocated for discounts are used for their intended purposes?

If, as indicated in #13, above, discounts are returned directly to institutions, no mechanisms are required for determining whether or not discounts are used for their intended purposes. Eligible institutions should be able to use savings from discounts at their discretion, and providers should have the opportunity to offer additional or enhanced telecommunications services as an alternative to actual discounts, operating under fair rules of competition.

15.) What is the least administratively burdensome requirement that could be used to ensure that requests for supported telecommunications services are bona fide requests within the intent of section 254 (h)?

The least administratively burdensome methodology for certifying eligibility for discount rates is to make eligible any institution that is operating under the administrative charter of the state education agency, and/or state agency responsible for the oversight and administration of libraries.

16.) What should be the base service prices to which discounts for schools and libraries are applied: (a) total service long-run incremental cost; (b) short-run incremental costs; (c) best commercially-available rate; (d) tariffed rate; (e) rate established through a competitively-bid contract in which schools and libraries participate; (f) lowest of some group of the above; or (g) some other benchmark? How could the best commercially-available rate be ascertained, in light of the fact that many such rates may be established pursuant to confidential contractual arrangements?

The best methodology for the application of discount pricing for universal service support is to apply the discount to rates established through a competitively-bid contract in which schools and libraries participate (option e). The issue that needs to be repeated again is that there has been, and continues to be, considerable debate regarding cost-based pricing models. In the long term, the principles of competition expressed in Section 706 should prevail with respect to the protection of the public interest in affordable rates. Universal service support should not pertain where it can be proven that competition has been effective in producing affordable rates. See also response to question # 23.

For schools and libraries the use of cost-based pricing or proxy models for the establishment of benchmark cost models does not appear to have been sufficiently addressed. Plans advanced by some providers in response to universal service support mechanisms for education seem to use pricing models based on current tariffed rates or existing market pricing. The degree to which this pricing is based on real cost is unclear, with the result that estimates for the cost of a universal service fund for schools and libraries may be inflated. For this reason, competitively-bid contracts may tend to provide a more accurate reflection of base service pricing to which discount pricing for schools and libraries should then be applied.

17.) How should discounts be applied, if at all, for schools and libraries and rural health care providers that are currently receiving special rates?

Discounts for universal service support should be applied only in instances where special rates are still higher than competitively-bid rates minus the discount rate. A possible inadvertent competitive advantage could accrue to companies that would undermine the public interest of the Fund.

18.) What states have established discount programs for telecommunications services provided to schools, libraries, and health care providers? Describe the programs, including the measurable outcomes and the associated costs.

New York State has not established any discount rate plan for schools and libraries pursuant to universal service provisions.

19.) Should an additional discount be given to schools and libraries located in rural, insular, high-cost and economically disadvantaged areas? What percentage of telecommunications services (e.g., Internet services) used by schools and libraries in such areas are or require toll calls?

All discounts pursuant to universal service support should be based on "institutional ability to pay" to ensure that the most in need institutions can derive the greatest benefit from universal service subsidies. The universal service support structure should recognize that there are increased costs associated with the development of telecommunications infrastructure in geographically and economically disadvantaged areas, especially mileage-sensitive rural areas of

the state. Moreover, in the event that the Universal Fund program generates a smaller-than-anticipated amount of resources, we recommend that these funds be equalized according to the institutional wealth measures determined by the states.

20.) Should the Commission use some existing model to determine the degree to which a school is disadvantaged (e.g., Title I or the national school lunch program)? Which one? What, if any, modifications should the Commission make to that model?

The Commission should rely on existing statistical measures used by the U.S. Department of Education to apportion aid to most-in-need schools. Measures that are based on actual counts of students in need of special services (number of students eligible for free or reduced price lunch-Chapter 1, aid for dependent children-AFDC) or other such measures are probably the most accurate indicators of need. Further, these schools would also be most likely to be recipients of other funding that could be targeted to support professional development and training in the use of telecommunications and networking and to support applications that take the best advantage of networked instructional resources.

21.) Should the Commission use a sliding scale approach (i.e., along a continuum of need) or a step approach (e.g., the Lifeline assistance program or the national school lunch program) to allocate any additional consideration given to schools and libraries located in rural, insular, high-cost, and economically disadvantaged areas?

The response to question 19 is applicable to this question

22.) Should separate funding mechanisms be established for schools and libraries and for rural health care providers?

It is unlikely that the infrastructure or operational costs associated with telecommunications services would be significantly different among kinds of institutions. In the interest of promoting community network development and aggregate market purchasing power, it is advisable to support the development of a common funding mechanism across sectors.

23.) Are the cost estimates contained in the McKinsey Report and NII KickStart Initiative an accurate funding estimate for the discount provisions for schools and libraries, assuming that tariffed rates are used as the base prices?

The methodology behind the McKinsey study and the NII Kickstart Initiative appears to be sound and could be used as a basis for establishing discount provisions. The methodology also applies whether or not tariffed rates are used as base pricing. These studies, however, should be used only as baseline studies and the "model" should not be extrapolated to a standard approach to the development of telecommunications infrastructure. The "partial classroom" pricing model should be considered as an average configuration to be used for pricing purposes only. No organization should feel constrained by this model when making decisions regarding the most

appropriate configuration for their use. Library-specific models may need to be developed that reflect their unique configurations.

25.) Are there any specific cost estimates that address the discount funding estimates for eligible private schools?

There is no evidence to suggest that the cost estimates for private schools would be substantially different than those established for public schools.

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